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SUBJECT: GERMANY: IT SECTOR INSOLVENCY IN DRESDEN LEADS TO CALLS FOR PROTECTIONISM

¶1. (U) Summary. Qimonda, a worldwide leading manufacturer of dynamic random access memory chips (DRAM) with facilities in Dresden (3,200 employees), Munich (1,400) and Richmond, Virginia (2,800), filed for insolvency January 23 after a rescue plan devised by parent company Infineon, the state of Saxony and a Portuguese development bank failed. The closure of Qimonda would be a serious blow for Dresden's image as a high-tech center and would affect companies servicing the local semiconductor industry, research institutes and university programs. Qimonda managers argue the dramatic fall in DRAM chip prices in the second half of 2008 is responsible for the firm's bankruptcy while economic analysts blame politicians for failing to fight extensive subsidies in Asia. Industry insiders and economists called for engaging the WTO or introducing tariffs for chips produced under what critics see as unfair conditions. End Summary.

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World's Leading Company for DRAM Products Files for Insolvency  
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¶2. (U) On January 23, 2009 Munich-based dynamic random access memory chips (DRAM) producer Qimonda AG, and Qimonda Dresden OHG filed an application to initiate insolvency proceedings. Qimonda employs 12,200 worldwide, including 1,400 in Munich, 3,200 in Dresden and 2,800 in Richmond, Virginia. The company was founded in 2006 as a branch of Infineon, which still holds 77.5 percent of the shares. (Note: In December 2008, Infineon, a former subsidiary of German industrial conglomerate Siemens, issued a very gloomy report for itself and Qimonda, with a loss of 3 billion Euro for its financial year ending September 30. End Note.) Qimonda has struggled to compete against larger rivals and stiff competition from Asia, where DRAM chip production costs and final product prices are significantly lower.

¶3. (U) Qimonda introduced a global restructuring and cost reduction program last October after a drastic fall in chip prices. A 325 million Euro bailout package was arranged between the state of Saxony, a Portuguese development bank and Infineon. Saxony promised 280 million Euro in additional guarantees, but the deal failed when Qimonda announced a 300 million Euro financing gap on January 22, 2009. Saxony's Minister President Stanislaw Tillich (CDU) said the insolvency could be a "second chance" for the company, emphasizing Saxony's portion of the previously-announced state assistance package is still on the table. (Note: The insolvency proceeding will allow Qimonda to find new investors and to restructure within the context of the insolvency regime.)

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The Blame Game  
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¶4. (U) Qimonda managers argue that the dramatic fall in DRAM chip prices in the half of 2008 is responsible for the firm's bankruptcy and claim the company could have lowered production costs and remained competitive had it received state subsidies earlier. Industry insiders and union representatives, however, blame management for having failed to switch production to more efficient technologies earlier. Economists resurrected an old criticism that politicians fail to fight international subsidy

practices. DRAM producers in China and Indonesia are reportedly heavily subsidized, receiving 70 percent of investment costs as a public subsidy while EU regulations permit only 30 percent for European companies. Economists have called for the EU to stop this practice through tariffs or the WTO.

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Setback for Silicon Saxony  
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¶15. (U) The closure of Qimonda would be a serious blow for Dresden's image as a high-tech center and would affect companies servicing the local semiconductor industry, research institutes and university programs. There are 1200 IT companies employing 40,000 in the Dresden region. More than 5,000 students major in fields related to semiconductors or information technology at the Technical University of Dresden alone. Without Qimonda's R&D division, the area could lose legitimacy as a cluster of semiconductor expertise.

¶16. (U) While Qimonda is teetering on the edge, neighboring Advance Micro Devices (AMD), a U.S. firm, has escaped pressing financial problems by setting up a joint venture with Advanced Technology Investment, a vehicle owned by the emirate of Abu Dhabi. The venture, known as the Foundry Co., is investing \$2.9 billion to upgrade one of AMD's two factories in Dresden. To keep its 2,800 strong workforce stable, AMD will work reduced hours from February to July.

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Comment  
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¶17. (U) Qimonda's insolvency was no surprise as management, the State of Saxony, and Infineon began working on a rescue package last fall, but Qimonda's inability to present a convincing business plan stalled a decision. Qimonda's possible demise underscores the risks in investing in IT when a company's competitiveness depends heavily on the ability and willingness of local governments to support it. The calls for increased state support and higher tariffs following Qimonda's insolvency are not surprising and demonstrate the growing pressure to resort to protectionism in the IT/high tech sector as the economic crisis starts to take its toll. End Comment.

¶18. (U) This message was coordinated with Embassy Berlin and Consulate General Munich.

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